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No. 82-676

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1982

SAUSALITO PHARMACY, INC.,
Petitioner,

vs.

BLUE SHIELD OF CALIFORNIA, TRAVELERS INSURANCE CO., METROPOLITAN LIFE INSURANCE CO., d/b/a MEDIMET, AETNA LIFE INSURANCE CO., HEALTH SYSTEMS INSTITUTE, PAID PRESCRIPTIONS INC., a Nevada Corporation, PAID PRESCRIPTIONS INC., a New Jersey Corporation, PHARMACEUTICAL CARD SYSTEMS, INC., PRE-PAID PRESCRIPTION PLANS, INC. and U.S. ADMINISTRATORS, INC.,
Respondents.

On Petition for Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

MORRISON & FOERSTER
One Market Plaza
Spear Street Tower
San Francisco, CA 94105
(415) 777-6000

MELVIN R. GOLDMAN
ROCHELLE D. ALPERT*
JACK W. LONDEN
Attorneys for Pharmaceutical Card Systems, Inc.

*Counsel of Record

(Other counsel listed inside of front cover)

COUNSEL OF SAN FRANCISCO, INC. • 950 SIXTH ST. • S.F., CA 94103 • (415) 864-0600

HASSARD, BONNINGTON, ROGERS & HUBER
3300 Wells Fargo Building
44 Montgomery Street
San Francisco, CA 94104
(415) 781-6767

SHARTSIS, FRIESE, & GINSBURG
One Maritime Plaza
18th Floor
San Francisco, CA 94111
(415) 421-6500

KEESAL, BOLAND & EGGLESTON
100 Pine Street, 32nd Floor
San Francisco, CA 94111
(415) 362-0884

MORRIS, JACOBS, PETRIE & GREEN
1801 Century Park East
25th Floor
Los Angeles, CA 90067
(213) 556-2000

ADAMS, DUQUE & HAZELTINE
333 West Sixth Street
Los Angeles, CA 90014
(213) 620-1240

GIBSON, DUNN & CRUTCHER
2029 Century Park East
Suite 4000
Los Angeles, CA 90067
(213) 552-8500

MCCUTCHEN, DOYLE, BROWN & ENERSEN
Three Embarcadero Center
20th Floor
San Francisco, CA 94111
(415) 393-2000

DAVID B. WILLEY
PATRICIA J. DORAN*
Attorneys for California Physician's Service d/b/a Blue Shield of California

PAUL M. GINSBURG*
STEWART H. FOREMAN
Attorneys for Health Systems Institute

RICHARD J. KILMARTIN*
Attorneys for Metropolitan Life Insurance Company

SHERWIN L. MORRIS*
MARILYN J. SCHNEIDER
Attorneys for U.S. Administrators, Inc. and Prepaid Prescription Plans, Inc.

JOHN H. BRINKLEY*
JEFFREY P. SMITH
Attorneys for Paid Prescriptions, Inc., a Nevada corporation and Paid Prescriptions, Inc., a New Jersey corporation

JOHN J. SWENSON
THOMAS E. HOLLIHAN*
Attorneys for Aetna Life Insurance Company

JOHN EDWARD HUMLEY*
CRAIG MCATEE
ROBERT A. LEWIS
Attorneys for The Travelers Insurance Companies

*Counsel of Record

QUESTIONS PRESENTED

I. Whether the Court of Appeals and the District Court, consistent with decisions of this Court and other federal courts, correctly held that respondents' pharmacy agreements as a matter of law do not amount to unreasonable vertical restraints of trade?

II. Whether the Court of Appeals and the District Court, applying well-established precedent, correctly held that no significant probative evidence supported a finding that any respondent participated in any horizontal combination to restrain trade?

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Respondents.

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BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Respondents—a health care service plan, insurance companies and plan administrators—file this brief in opposition to the petition of Sausalito Pharmacy, Inc. (hereinafter "Sausalito Pharmacy") for a writ of certiorari to review the judgment in this case by the United States Court of Appeals for the Ninth Circuit in favor of respondents. The decisions below are not in conflict with any holding of this Court or with the decisions of any other circuit. Indeed,

they are fully consistent with all decisions under Section 1 of the Sherman Act which have considered the antitrust legality of insurance provider agreements, including pharmacy provider agreements. Nor do the decisions below present an important undecided question of law. The courts below did no more than apply fundamental antitrust principles to an undisputed factual record.

STATEMENT OF THE CASE

A. Proceedings Below

On September 15, 1978, fifteen retail pharmacies filed this action, alleging, among other violations, violations of Section 1 of the Sherman Act, 15 U.S.C. § 1.[1] Petitioner, Sausalito Pharmacy, remains as the only retail pharmacy pursuing this action.[2]

Specifically, the core of petitioner's case focused on the primary mechanism by which prescription drug benefits are provided to insureds or subscribers (hereinafter "insureds") under prepaid prescription drug plans: the agreements between the plans and retail pharmacies. (App. A, A-3.)[3] First, petitioner contended that the provisions in

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[1] Initially, petitioner alleged violations of every section of the antitrust laws, but during the course of discovery petitioner restricted its allegations solely to Section 1 of the Sherman Act, 15 U.S.C. § 1. (Appendix B of the Petition, A-14, hereinafter "App. B".)

[2] All retail pharmacies except Sausalito Pharmacy sought dismissals of this action prior to judgment by the District Court or did not pursue an appeal to the Ninth Circuit. Significantly, in its petition, Sausalito Pharmacy continues to challenge all respondents' pharmacy agreements as vertical price fixing under Section 1 of the Sherman Act, while failing to acknowledge to this Court that it has never entered into pharmacy agreements with any respondent other than Paid Prescriptions Inc.

[3] "App. A" refers to Appendix A of the Petition.

these agreements that preclude pharmacies from charging insureds covered by prepaid, prescription drug plans more than the deductible specified in the plans constituted a vertical combination to fix the maximum price for prescription drugs. (*Id.*) Second, petitioner contended that the payment provisions of the pharmacy agreements constituted a horizontal combination among the plans to fix the maximum price for prescription drugs. (*Id.*)

In October 1979, petitioner moved for summary judgment on the basis that the contracts between respondents and retail pharmacies constituted a *per se* violation of Section 1 of the Sherman Act. (App. A, A-3.) In ruling on the motion for summary judgment, the District Court held that the pharmacy agreements did not constitute a *per se* violation of the antitrust laws, based primarily on this Court's decision in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). (*Id.*, A-4-5.) Moreover, the District Court held that petitioner had not come forth with any evidence of a horizontal conspiracy. (*Id.*, A-3.)

After the close of discovery, all respondents moved for summary judgment. (App. B, A-11.) After extensive briefing and oral argument, the District Court, on March 16, 1981, granted summary judgment in favor of respondents. (App. B.) First, the District Court held that the pharmacy provider agreements do not constitute unreasonable vertical restraints of trade. (App. B, A-14-25.) Based on the express holding of this Court in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), the District Court found that the pharmacy agreements are "'arrangements for the purchase of goods and services,'" (App. B, A-15) and thus, "constitute agreements between the buyers and sellers of goods" (*Id.*), which are not *per*

se violations of Section 1 of the Sherman Act. The District Court applied this conclusion equally to pharmacy agreements between pharmacies and insurance companies, to those between pharmacies and health care service plans and to those between pharmacies and plan administrators. (App. B, A-15.) Having found, as a matter of law, no *per se* violation, the District Court examined the pharmacy agreements under the rule of reason and concluded that petitioner failed to point to any significant probative evidence of an unreasonable restraint of trade—"contracts between purchasers and sellers do not impermissibly restrain trade unless there is some effect on price formation other than the terms of the contract itself." (*Id.*, A-24.) Second, the District Court found that the pharmacy provider agreements did not evince an illegal implied horizontal combination, since petitioner failed to present any significant probative evidence of an unlawful combination and any viable legal theory. (*Id.*, A-35.)

In a *per curiam* opinion, the Court of Appeals affirmed the District Court's decision, ruling "no viable antitrust claim was stated . . . for the reasons stated in [the District Court's] opinion." (App. C, A-38.)[4] Petitioner's petition for rehearing was denied on June 21, 1982. (App. E.)[5]

B. Statement of Facts

As petitioner emphasizes, respondents' pharmacy agreements are similar in operation to the one at issue in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). (Petition, p. 3.) The pharmacy agreements set forth the basic structure of the payments made by the pre-

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[4] "App. C" refers to Appendix C of the Petition.

[5] "App. E" refers to Appendix E of the Petition.

paid drug plans to participating pharmacies for insureds' prescription drug needs: the prepaid drug plans pay participating pharmacies the ingredient cost of the drug, plus a dispensing fee, less the specified plan deductible. (App. B, A-12.)

The first payment component to participating pharmacies, the ingredient cost, is determined by market constraints and generally equals or exceeds the participating pharmacies' actual acquisition costs for prescription drugs from their suppliers. (*Id.*)

The second payment component, the dispensing fee, is also determined by market constraints. The health care service plan or insurance company (hereinafter "insurer") for the prepaid drug plan determines individually the amount to pay participating pharmacies for dispensing prescriptions to its insureds. (*Id.*) This component varies among insurers and among plans administered by each insurer. (*Id.*) At any time, each participating pharmacy can evaluate each insurer's dispensing fee offer: the pharmacy can decide whether it considers each insurer's offer to be economically satisfactory, and on that basis, whether it desires to participate in any prepaid drug plans. (*Id.* at A-13.)

Finally, the third payment component, the deductible or co-payment, is determined by the market constraints inherent in the insurance contract between the insurer and the insured. That is, the insured contracts with the insurer to receive certain designated prescription drug benefits in exchange for a premium paid to the insurer. (*Id.* at A-12.) The amount of the deductible also varies among insurers and among plans administered by each insurer. (*Id.*)

Prepaid prescription drug plans with a deductible of zero provide the simplest illustration of the operation of these insurance plans. While the participating pharmacy physically dispenses the prescription drug to the insured policyholder, and not the insurer, the participating pharmacy must look solely to the insurer for payment of the prescription drug dispensed. In short, the insurer purchases the prescription from the participating pharmacy for delivery to the insured at the ingredient cost and the predetermined dispensing fee.

REASONS FOR DENYING THE WRIT

Rule 17 of the Rules of the Supreme Court requires "special and important" reasons for review on writ of certiorari. In an effort to meet this requirement, petitioner attempts to create first, a conflict between the decisions below and the decisions of this Court in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979) and *Arizona v. Maricopa County Medical Society*, ... U.S. ....., 102 S. Ct. 2466 (1982), and second, a conflict among the circuits. Petitioner's efforts find no support in the decisions below, in this Court's decisions in *Royal Drug* and *Maricopa County* or in the decisions of other federal courts on similar issues. Accordingly, the petition for a writ of certiorari should be denied: there is no question presented appropriate for this Court's review.

I. The Decisions Below Properly Applied This Court's Holding in Group Life & Health Insurance Co. v. Royal Drug Co., Subjecting Petitioner's Claims to Traditional Antitrust Analysis

Petitioner erroneously asserts that the holdings of the Court of Appeals and the District Court are in conflict with *Group Life & Health Insurance Co. v. Royal Drug Co.*,

440 U.S. 205 (1979). (Petition, pp. 9-11.) However, these contentions fly in the face of the express holding of this Court in *Royal Drug* as the District Court and Court of Appeals in this case aptly noted.

In *Royal Drug*, this Court reviewed Blue Shield pharmacy agreements similar to the pharmacy agreements at issue in this lawsuit and held that such pharmacy agreements were not " 'the business of insurance' " for purposes of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b). (440 U.S. at 214.) More importantly for purposes of this petition, in deciding that this type of provider agreement is not "the business of insurance" and not totally immune from antitrust scrutiny, this Court concluded that these contracts "are merely arrangements for the purchase of goods and services" by the insurer. (*Id.*)[6] This Court, however, refrained from reaching the merits of the antitrust claim in *Royal Drug*. (*Id.* at 210.)

The decisions below analyzing petitioner's vertical price fixing claims followed precisely these mandates of *Royal Drug*, scrutinizing the agreements pursuant to well-established antitrust principles.[7] On the basis of *Royal Drug*, the District Court concluded that the pharmacy agreements "constitute agreements between the buyers and

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[6]This Court's latest decision involving health care and the antitrust laws, *Union Labor Life Insurance Co. v. Pireno*, ... U.S. ..., 102 S.Ct. 3002, 3008 (1982), quotes and applies this very language of *Royal Drug*, confirming that the District Court and the Court of Appeals were correct in concluding that this Court meant what it said.

[7]Contrary to petitioner's characterization (Petition, p. 10), the District Court specifically noted that *Royal Drug* did not reach the question of whether pharmacy agreements violate the antitrust laws (App. B, A-17).

sellers of goods." (App. B, A-15.) As such, they do "not set prices to be charged third parties" and do not amount to *per se* violations of Section 1 of the Sherman Act. (*Id.* at A-16.) Having found, as a matter of law, no *per se* violation, the District Court determined that "the issue to be decided is whether these agreements are *unreasonable* vertical restraints of trade." (*Id.* at A-16-17.) Only after extensive scrutiny of the pharmacy agreements under traditional rule of reason principles did the District Court conclude, as a matter of law, that the pharmacy agreements did not amount to an unreasonable restraint of trade. (*Id.* at A-17-25.)

The decisions below do not rest on any conclusion that the pharmacy agreements "supersede" the antitrust laws (Petition, p. 7). Rather, the District Court and the Court of Appeals properly followed *Royal Drug*, analyzed the pharmacy agreements under traditional antitrust principles and concluded no Sherman Act Section 1 violation was demonstrated.

II. The Decisions Below Do Not Conflict With Any Decisions by Any Other Circuit and Are Consistent with Every Case Which Has Subjected Similar Conduct to Analysis Under the Antitrust Laws

All decisions subsequent to this Court's decision in *Royal Drug* unequivocally hold that pharmacy provider agreements and provider agreements in various insurance contexts are simply arrangements for the purchase of goods and services and not unreasonable restraints of trade under Section 1 of the Sherman Act. Nevertheless, petitioner attempts to contrive a conflict among the Ninth Circuit's decision in this case, the Second Circuit's decision in *Medical Arts Pharmacy of Stamford, Inc. v. Blue Cross and*

Blue Shield of Connecticut, Inc., 675 F.2d 502 (2d Cir. 1982) and the Fifth Circuit's decision in *Royal Drug Co. v. Group Life & Health Insurance Co.*, 556 F.2d 1375 (5th Cir. 1977), *aff'd on other grounds*, 440 U.S. 205 (1979). Each of these alleged conflicts is illusory.

First, as to the alleged conflict with *Medical Arts Pharmacy of Stamford, Inc. v. Blue Cross and Blue Shield of Connecticut, Inc.*, 675 F.2d 502 (2d Cir. 1982), that case analyzed pharmacy agreements pursuant to Sherman Act Section 1, and as did the Ninth Circuit, affirmed summary judgment in favor of defendant-appellee. Contrary to petitioner's characterization, the Second Circuit in *Medical Arts Pharmacy* followed *Royal Drug* stating:

> Whether Blue Cross is characterized as a purchaser or simply as an indemnitor or third-party payor, *it is the ultimate payor*, and therefore its prescription drug plan differs significantly from the vertical arrangements to restrict resale prices that were invalidated in *Albrec* and *Keifer-Stewart*.
>
> • • •
>
> In short, the challenged conduct by Blue Cross is not governed by *Albrecht* and *Kiefer-Stewart*, but is *sui generis*. Although the pharmacy agreements do fix prices, and are not precisely between seller and purchaser (but between seller and indemnitor), they are not manifestly anticompetitive.

(Id. at 505-06.) (Emphasis added.)

Moreover, the Second Circuit, like the Ninth Circuit, analyzed the pharmacy's claims under the rule of reason. In fact, contrary to petitioner's characterization (Petition, p. 13), the gravamen of the pharmacy's arguments in *Medical Arts Pharmacy* was similar to petitioner's argu-

ments in this case: insurers pay less for prescription drugs than cash and carry customers. (*Compare* 675 F.2d at 507 *with* Petition, p. 13.) To this argument, the Second Circuit in *Medical Arts Pharmacy* responded in virtually the same manner as the District Court and the Court of Appeals in this case:

> A low profit margin on sales to Blue Cross subscribers could not, however, establish an antitrust violation under the rule of reason. *See Brown Shoe Co. v. United States*, 370 U.S. 294, 320, 82 S.Ct. 1502, 1521, 8 L.Ed.2d 510 (1962) (the antitrust laws were enacted for "the protection of *competition*, not *competitors*") (emphasis in original); *Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126, 133-34 (2d Cir. 1978) (en banc). (675 F.2d at 507.)[6]

Accordingly, the Second Circuit is in accord, *not* in conflict, with the Ninth Circuit. Indeed, contrary to petitioner's assertion, the Second Circuit relied on the District Court's decision in this case (*Id.* at 504), and the Ninth Circuit in this case relied on the Second Circuit's decision in *Medical Arts Pharmacy* (App. C, A-38).

As to petitioner's further alleged conflict between the Ninth Circuit and the Fifth Circuit, it suffices to point out that the decision in *Royal Drug Co. v. Group Life & Health Insurance Co.*, 556 F.2d 1375 (5th Cir. 1977) preceded this Court's affirmance of that decision on other grounds (440

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[6]Petitioner argues that, unlike the pharmacy in *Medical Arts Pharmacy*, it claimed that it was forced to charge cash and carry customers more in order to obtain a certain overall profit. (Petition, p. 13.) As the District Court held, "this is a business decision to be made by [petitioner] upon . . . entering into a contract with [respondents]." (App. B, A-27-28 n.2.) It does not evidence any unreasonable effect of pharmacy agreements on competition. *(Id.)*

U.S. 205), and did not purport to address whether pharmacy agreements violated the antitrust laws, but merely whether they were exempt under the McCarran-Ferguson Act.

Petitioner's arguments ignore the numerous other federal court decisions, some of which the District Court here specifically relied on, which uniformly hold that pharmacy provider agreements and provider agreements in other insurance contexts are arrangements for the purchase of goods and services and present no unreasonable restraint of trade. *See Proctor v. State Farm Mutual Automobile Insurance Co.*, 675 F.2d 308 (D.C. Cir. 1982), *cert. denied*, 51 U.S.L.W. 3225 (Oct. 4, 1982) (automotive repair services provider agreement); *Quality Auto Body, Inc. v. Allstate Insurance Co.*, 660 F.2d 1195 (7th Cir. 1981), *cert. denied*, ... U.S. ....., 102 S. Ct. 1717 (1982) (automotive repair services provider agreement); *Feldman v. Health Care Service Corp.*, No. 78 C 2621, slip opinion (N.D. Ill. Sept. 30, 1982) (pharmacy provider agreement); *Nationwide Mutual Insurance Co. v. Automotive Service Councils*, 1981-1 Trade Cas. ¶ 63,958 (D. Del. 1981) (automobile repair services provider agreement); *Blue Cross and Blue Shield of Michigan v. Michigan Association of Psychotherapy Clinics*, 1980-2 Trade Cas. ¶ 63,351 (E.D. Mich. 1980) (psychiatric services provider agreement).[9]

Moreover, this unwavering line of post *Royal Drug* cases finding provider agreements to be reasonable as a matter of law is in accord with the position the Department of Justice has taken with respect to pharmacy provider agree-

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[9]This Court's recent denials of petitions for certiorari in the *Quality Auto Body* and *Proctor* cases—which sought to raise issues similar to those urged by petitioner—point the way to the appropriate result here.

ments. In connection with the Supreme Court's decision in *Royal Drug*, the Department of Justice took the position that pharmacy agreements are "bilateral contracts for the purchase of goods and services." (Brief for the United States as *Amicus Curiae* in *Group Life & Health Insurance Co. v. Royal Drug Co.*, O.T. 1978, No. 77-952, at 11.) As such, the Department of Justice maintained that the pharmacy agreements do not evince a *per se* violation of the Sherman Act nor an unreasonable restraint of trade. (*Id.* at 12.) Specifically, the Department of Justice, with respect to allegations in *Royal Drug* that are virtually identical to those raised here, stated:

> Respondents' principal complaint seems to be that the series of Pharmacy Agreements . . . prevents them from obtaining as much money as they need or desire .... *That kind of complaint does not state an antitrust violation.* Nothing in the antitrust laws requires drug purchasers (or Blue Shield acting as their purchasing agent) to offer the greater compensation necessary to satisfy less efficient pharmacies or suppliers interested in providing expensive but unwanted services at the point of sale. To the contrary, antitrust policy seeks to preserve to consumers the opportunity to obtain a better deal. Its goal is consumer welfare, not competitor welfare.

(*Id.*) (Emphasis added.)

This Court in its decision in *Royal Drug* explicitly noted the Department of Justice position that pharmacy agreements "probably do not violate the antitrust laws . . ." (440 U.S. at 210 n.5.) More recently, in *Arizona v. Maricopa County Medical Society*, ... U.S. ....., 102 S. Ct. 2466 (1982), this Court again noted that the Department of Justice has taken the position that pharmacy agreements "would be legal unless . . . a conspiracy among providers

was at work." (*Id.* at 2478 n.26) Petitioner alleged no such conspiracy in this case.

Thus, the decisions below are in accord with decisions analyzing provider agreements in various insurance contexts, including other pharmacy agreements, and with the position of the Department of Justice as recognized by this Court in *Royal Drug* and more recently in *Maricopa County*.

III. The Decisions Below Properly Applied Recognized Antitrust Principles That Are Not Impacted by This Court's Decision in Maricopa County

Equally unmeritorious is petitioner's contention that this Court's decision in *Arizona v. Maricopa County Medical Society*, ... U.S. ....., 102 S. Ct. 2466 (1982) is inconsistent with the decision below. (Petition, p. 16-19.) Rather, this Court's recent decision in *Maricopa County* has no application here.

In *Maricopa County*, there was an undisputed factual record of a horizontal agreement among competing physicians to fix the maximum fees they claimed for health services provided to policyholders of specified insurance plans. (102 S. Ct. at 2469.) Based on established precedent, this Court held that such maximum fee agreements among competitors are *per se* unlawful under the Sherman Act. (*Id.* at 2472-80.)[10]

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[10]Petitioner argues, without supporting citation, that the District Court in granting summary judgment to respondents implicitly relied on the Ninth Circuit's erroneous holding in *Maricopa County* refusing to apply the *per se* prohibition of Section 1 of the Sherman Act. (Petition, p. 16.) The District Court's decision (App. B) speaks for itself: nowhere in that decision is there any express or implied reference to the Ninth Circuit's opinion in *Maricopa County*.

No such undisputed horizontal agreement among competitors exists here—just the opposite. The District Court found that petitioner failed to come forward with *any* "direct evidence of conspiracy." (App. B, A-35.) Indeed, the District Court found that respondents' pharmacy agreements "vary significantly." (*Id.*, A-29 n.4.) On this basis, the District Court held "summary judgment is appropriate: [petitioner's] version of the facts does not support a viable legal theory which, if accepted, would entitle [it] to judgment as a matter of law." (App. B, A-36.)[11]

Thus, this Court's decision in *Maricopa County* is irrelevant to the issues of this case. The District Court did not fail to apply the *per se* prohibition of Section 1 of the Sherman Act to petitioner's claims of a horizontal combination among respondents, but merely held that petitioner presented no evidence of any horizontal combination among respondents to restrain trade.

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[11]Petitioner does not dispute these conclusions of the District Court, but merely refers this Court to the identical, talismanic references to "price fixing" made to the Court of Appeals and the District Court. (Petition, p. 11 n.5.)

CONCLUSION

For the foregoing reasons, respondents respectfully request the Court to deny the petition for a writ of certiorari in the present case. The decisions below are entirely consistent with *Royal Drug, Maricopa County* and with those of other federal courts scrutinizing provider agreements under traditional antitrust principles. There are no "special and important reasons" for review of the grant of summary judgment in favor of respondents.

October 21, 1982

Respectfully submitted,

MORRISON & FOERSTER
One Market Plaza
Spear Street Tower
San Francisco, CA 94105

MELVIN R. GOLDMAN
ROCHELLE D. ALPERT*
JACK W. LONDEN
Attorneys for Pharmaceutical Card System, Inc.

HASSARD, BONNINGTON, ROGERS & HUBER
3500 Wells Fargo Building
44 Montgomery Street
San Francisco, CA 94104

DAVID E. WILLETT
PATRICIA J. DORAN*
Attorneys for California Physician's Service d/b/a Blue Shield of California

SHARTSIS, FRIESE, & GINSBURG
255 California Street
San Francisco, CA 94111

PAUL M. GINSBURG*
STEWART H. FOREMAN
Attorneys for Health Systems Institute

KNIGHT, BOLAND & RIORDAN
100 Pine Street, 33rd Floor
San Francisco, CA 94111

RICHARD J. KILMARTIN*
Attorneys for Metropolitan Life Insurance Company

MEMEL, JACOBS, PIERNO & GERSH
1801 Century Park East
25th Floor
Los Angeles, CA 90067

SHERWIN L. MEMEL*
MARTIN J. SCHNITZER
Attorneys for U.S. Administrators, Inc. and Prepaid Prescription Plans, Inc.

*Counsel of Record

ADAMS, DUQUE & HAZELTINE
523 West Sixth Street
Los Angeles, CA 90014

JOHN H. BRINSLEY*
JEFFREY P. SMITH
Attorneys for Paid Prescriptions, Inc., a Nevada corporation and Paid Prescriptions, Inc., a New Jersey corporation

GIBSON, DUNN & CRUTCHER
2029 Century Park East
Suite 4000
Los Angeles, CA 90067

JOHN J. SWENSON
THOMAS E. HOLLIDAY*
Attorneys for Aetna Life Insurance Company

McCUTCHEN, DOYLE, BROWN & ENERSEN
Three Embarcadero Center
28th Floor
San Francisco, CA 94111

JOHN EDWARD HURLEY*
CRAIG McATEE
ROBERT A. LEWIS
Attorneys for The Travelers Insurance Companies

*Counsel of Record

LISTING REQUIRED BY RULE 28.1

Pharmaceutical Card System, Inc.

A wholly owned subsidiary of Foremost-McKesson, Inc.

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